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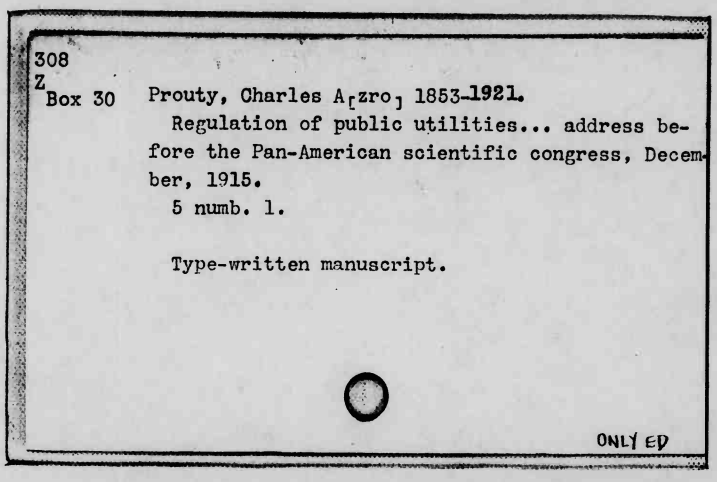
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REGULATION OF PUBLIC UTILITIES

By

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Address before the
Pan-American Scientific Congress,
December, 1915.

The discussion of this subject will be confined to the United States alone, and will be addressed to three aspects.

1. The reason for regulation.
2. The means employed.
3. The extent and success of the experiment.

I.

The public utilities of the United States are for the most part provided by private capital. While public ownership exists to a limited extent, it has never gained a considerable foothold in this country except in the furnishing of water for domestic uses. When the government "regulates" the utility it takes away from the proprietor the control of his property. The love of personal freedom; the right to do with his own what he will is peculiarly dear to the American citizen. By virtue of what principle then is the government permitted to lay its hand upon this species of property and take from its owner the right to control its use?

Various reasons have been alleged by courts and economists.

It has been said that the government might itself build and operate these utilities, as, for example, our railroads, and that therefore it may control. But does the conclusion follow? Granted that the government may do this thing; nevertheless, it has elected not to do it. It has permitted and invited private property to enter upon the discharge of this function. Should it not in justice leave this private property untrammeled?

It is urged that the agency which provides the utility is a corporation, the creature of the Government, and that, therefore, the Government, that is, the creator, may impose whatever conditions it sees fit upon the creature. Assuming that the Government might at the time of the creation impose whatever limitation it saw fit, should it after the corporation has begun business without restriction then for the first time fix the conditions. And again, taking our railroads as an illustration, the corporation which transacts the business is a creature of the individual state while the majority of that business is regulated by the Federal government.

It is said that the corporation in its operations is given the right of eminent domain and that since it is allowed to condemn the property of others in the discharge of its function, so its own property may be controlled, but here again the right of condemnation is by no means universal. In some states water companies, gas companies, electric light companies, cannot take <u>in invitum</u> the lands or water rights of others which may be needed in the development of their plants although their rates may be fixed by public authority.

The reason is broader than all this. It is founded upon public interest. These so-called public utilities are essential to the proper development of modern society. Society could not live and act in these days without the railroad, the telephone, the electric service, a proper water supply. The furnishing of these necessities is essentially a monopoly. The individual is helpless to protect himself against the corporation, therefore, society must protect him. The right of regulation rests upon the broad principle that the State must of necessity have authority to develop its activities and safe-guard its citizens. This right should not clothe injustice but without the right the state itself could not exist.

In most countries this right would be exercised as a matter of course; in this land of ours the attempt to regulate provoked bitter denunciation and the right itself was only established after long controversy before legislature and court.

In discussing the means to be employed we should always keep in mind the thing to be accomplished. That thing is the protection of the public, the protection of the individual who must patronize the utility, and this individual is interested in two respects.

First comes the service. The utility is a thing of necessity and that necessity is not supplied unless the service be adequate. If the utility be a gas company, then its gas must be of proper quality and furnished under proper pressure. If it be a street railway, its schedules must accommodate the public. If the steam railroads of this country are considered then their means of transportation must be adequate to handle the traffic both of freight and of people which is offered.

Indeed, it is probable that the service is of the greatest immediate consequence since by the want of adequate service the patron is incommoded and damaged. If the railroads of our land were unable for a considerable time to handle the business presented, the commerce and the industry of this nation would languish.

The other thing in which the public is interested is the rate; that is, the amount which the patron is required to pay for the service. And here again the rate may be improper for two reasons. It may be absolutely too high; that is to say, it may be more than the utility ought to charge.

It was formerly said by most people in discussing this subject that the utility was really a seller of the commodity which it produced, that the user was a buyer of that commodity and that the price ought to be governed like the price of other commodities, by the law of supply and demand. It was therefore just as foolish and improper to attempt to fix the rates of the utility as it would be to fix the price of a commodity. But it long since became evident that this is in no sense true. There is no element of bargain and sale in this transaction. The patron must use, he must obtain the thing used from this particular source, he can obtain it from no other source, and he must therefore pay the price which is required of him. Upon reflection it will appear that the rate charged by the utility is much more closely analagous to a tax which is imposed upon the user.

The rate may also be a source of discrimination and therefore unjust even though not inherently too high. It could be easily shown that the freight rates imposed by the railroads of this country may, and in the past have actually determined where cities shall be built, where business shall be transacted, and by what individuals that business shall be done.

These are the aspects which concern the patron of the utility; there is still a third aspect in which the entire community is indirectly interested.

The amounts involved in the rates of most public utilities are insignificant when applied to a single unit. The issue is generally a few cents per thousand feet of gas, or per kilowatt hour of electricity, or per hundred pounds of freight. But the gross amounts are enormous. The total operating revenues of the railroads of the United States for the year ending June 30, 1914, were in excess of three billion dollars. One cent per ton applied to the total tonnage handled by these same railroads for that year would amount to almost nineteen and one half million dollars.

This species of property tends more than almost any other to add to and perpetuate itself. The individual piece of property wears out and is thrown away, but the property of the utility as a whole continually grows. There is a constant disposition to increase the value of the property from the earnings of the property itself. It appeared in what is known as the "Eastern Rate Advance Case" before the Interstate Commerce Commission that the Pennsylvania Railroad had invested in its lines east of Pittsburgh during the ten years preceding 1909 $110,000,000 out of its earnings. It had long been the policy of that company to invest in the property out of its collections from the public an amount equal to that paid its stockholders in dividends. A moment's reflection will show that if these public utilities are allowed to pay their stockholders an adequate sum for the use of the money invested and to put into their property for the benefit of these same stockholders an equal amount; if to this be added the increment in the value of their lands, we have an ever increasing snowball insignificant at the outset but which may finally become an avalanche.

For these reasons it is essential to the just protection of the community that the rate charged by the utility shall be reasonable. It is just as essential for reasons to be pointed out later that this rate shall be fair to the utility itself.

What means have been employed to effectuate these purposes, i.e.to secure a proper service for a proper charge?

The American citizen, as already suggested, loves individual freedom. While he has no very definite idea of what the wordmeans, paternalism is highly offensive to him. He will endure a considerable amount of inconvenience from others rather than submit to the adoption of methods which put any real constraint upon his own activities. The disposition of such a people is to interfere as little as possible with the management of private property. Such a people would naturally lay down general laws determining the conditions under which property might enter upon the discharge of these quasi-public functions, leaving to the courts the enforcement of these laws when violated. And this was exactly the method employed at the outset and persisted in for a considerable time both in England and in this country. Statutes were enacted prohibiting discrimination and the charging of unreasonable rates. If these statutes were violated the aggrieved party was remitted to the courts where he might recover damages for the wrong inflicted upon him.

It soon became evident that this method of procedure did not in fact accomplish its purpose. The amount involved to the individual who paid the rate or suffered from the discrimination in a single case was usually small while the total amount involved to the utility was large. The individual could not afford to prosecute to a final judgment a suit for damages, and in point of fact while complaints against unreasonable and discriminating rates were universal, such suits were but rarely begun.

Again, the damages which were recovered looked only to the past and not to the future and were awarded only in favor of the individual bringing the suit. If a railroad company were convicted of having charged an exorbitant rate and compelled to refund in some few instances, there still remained in its treasury the great bulk of its improper gains. As time went on it became evident that the only way in which to secure substantial protection for the public was to prescribe the service which the utility should render and the rate at which that service should be rendered and to compel the observance of this requirement. In that way justice was secured without favoritism for the entire public and in no other way could this be accomplished.

The various utilities bitterly resisted all attempts to apply this idea both before legislatures and in the courts. The outcome after years of discussion and court decision is this.

1. The government may fix the measure of service and the rate at which that service shall be rendered, and may compel the utility to observe this order.

2. Under the federal constitution and under the constitutions of most states the functions of government are divided into legislative, executive, and judicial, and those functions which properly pertain to one branch of the government cannot be exercised by any other. It has been held that the regulation of puolc utilities by prescribing their rates and practices is a legislative function which cannot be delegated to the courts. The legislature may exercise this right either directly or by the appointment of a commission which within the limits of its power may exercise the same authority.

3. The courts cannot revise or modify the act of a legislature in this behalf nor the order of a legislative commission, provided that the commission acts within its delegated authority and provided that the requirement, whether by legislature or commission, is not, for the want of a better word, confiscatory.

The machinery of regulation is being worked out under the foregoing principles. In many cases legislatures have determined by statute matters connected with the construction and operation of a utility, as, for example, what sort of headlight shall be used upon a locomotive or what shall constitute a train crew. Statutes have also beenpassed prescribing the rate at which freight and passengers shall be carried. The legislature might if it saw fit proceed in this way with all public utilities but in point of fact that method would be an extremely cumbersome one and the usual plan at the present time is to create a legislative commission to which is given in more or less complete degree the power of regulation. Such a commission usually has authority to make orders within prescribed limits and these orders when made are either self-executory or will be enforced by mandatory process of the courts. The courts, as already said, have no power to modify the order although they may under certain conditions set it aside.

The federal government and most states have created commissions of this kind. The powers of many of these commission, including the federal commission, are still incomplete but the tendency is to give to such commissions full authority over all the activities of the utility. They may control the issuing of its securities and, therefore, its development; may prescribe the standards by which it shall be constructed; may determine the rules under which it shall be operated and the rates which it may charge. It is evident that a commission of this kind possessed of these powers has the needed authority to completely safe-guard the interests of the public.

III.

In determining the measure of success which has attended government regulation of public utilities up to the present time, the thing aimed at must still be kept in mind. That thing is the good of the public. The government itself might render for its citizens the services which are rendered by the public utility. While this is no discussion of government ownership, still there must be some standard by which the test of success is to be applied and the inevitable question in the minds of all people must be, can the government obtain as favorable results by regulation which it would obtain if it rendered the service itself?

It will be remembered that there are two points at which the patron of the utility is affected - the service which is rendered and the price which is charged. So far as the service is concerned the regulating commission has or may have the most perfect control. Take for illustration the street railway. It can prescribe the kind of cars to be used, the sort of track upon which those cars shall be run, the frequency with which and the speed at which they shall be operated. Every item which enters into the rendering of that service for the public is under the control of the regulating tribunal.

And this is true of all utilities. The government may fix the standards of construction and determine the conditions of operation. It can impose upon the utility by its orders whatever it might itself do if it were actually rendering the service. And if the order be not obnoxious as an excess of authority or in violation of constitutional limitation, the utility can be compelled to obey its requirement.

The next thing is the rate, and here the control of the government is even more complete than with the service. Today most utilities are required to publish for the information of the public the rates to be charged for the performance of their services and are not permitted to collect different rates under heavy penalty. While the utility is generally allowed to make its own charge in the first instance, that charge is subject to alteration by the commission. The government may, in effect, fix the rate which the utility receives.

If the sole purpose be to protect the patron of the utility or the general public against abuse, the government can exercise the same restraining influence through regulation as though it operated the utility itself.

But there is a reverse side to this protective shield. A given service cannot be rendered unless the utility possesses adequate means to the end. Freight cannot be transported without cars and engines. The government may order the utility to provide itself with those facilities which are needed for the rendition of the service, but it cannot compel this unless that utility has the money with which to procure what is needed. When the utility is operated by private capital this money must come from private investment while the government can provide by taxation, if necessary, the needed means. No law can force private capital into investment in a public utility. If, therefore, under governmental regulation the utility cannot obtain the necessary funds with which to maintain and develop its property in such degree as to meet the demands upon it, the service must be impaired.

This is the point at which regulation will break down if at all. Can private capital be induced under the treatment which is accorded that capital by the regulating body to invest. If government ownership ever comes in the United States it will probably be because private capital cannot be obtained in sufficient amounts to afford an adequate service.

Up to the present time such has not been the case. The large amounts of private capital which are invested in public utilities are of little value except in the operation of the utility itself. If, therefore, the [illegible] government directs a railroad to do a certain thing, the property invested in that railroad must in self-protection obey that order. This will be done until the credit of the company has been exhausted. Effective and comprehensive regulation is of recent date and its final effect upon the investing public has yet to be demonstrated by actual experience.

Up to the present time in this country regulation has resulted in much benefit to the public. Facilities and service have been distinctly improved and there is no reason why the beneficent effect in these particulars should not continue.

Rates have been reduced. The tendency is that way. The public which pays the rate and which has little idea of what a reasonable rate is naturally desires to pay less. The commission which decides is inevitably influenced by public sentiment. Can rates be advanced as well as reduced?- until that question is answered the success of regulation cannot be assured, for an adequate service must be had; that service cannot be provided without adequate means and the money cannot be obtained from private investors unless a sufficiently attractive return is assured.

What this rate of return must be will depend upon the kind of utility and the conditions surrounding it, but in all cases it must be distinctly higher than the rate at which the government itself could borrow the money invested in the utility. Whether the government can afford to regulate will be the final inquiry. Up to the present time the experiment of regulation has hardly gone far enough to determine its ultimate success.

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